PARAGUAY

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators

(Millions of U.S. Dollars unless otherwise indicated)

	1996	1997	1998 1/
Income, Production, and Employment:			
Nominal GDP 2/	9,650	9,612	9,564
Real GDP Growth (pct)	1.2	2.7	-0.5
GDP by Sector (pct):			
Agriculture	26	27	26
Manufacturing	14	14	14
Services	36	37	37
Government	6.0	6.0	6.0
Per Capita GDP (1982 US$)	1,634	1,634	N/A
Labor Force (000s)	1,747	N/A	N/A
Unemployment Rate (pct)	9.8	12.0	12.0
Money and Prices (annual percentage growth):			
Money Supply Growth (M2)	13.3	7.7	-4.7
Consumer Price Inflation (pct)	8.2	6.2	14.6
Exchange Rate (GS/US$ Year End)	2,110	2,294	2,830
Official	N/A	N/A	N/A
Parallel	N/A	N/A	N/A
Balance of Payments and Trade:			
Total Exports FOB 3/	4,004	3,609	3,384
Exports to U.S. 3/	42.3	40.6	38.7
Total Imports CIF 3/	4,382	4,214	3,660
Imports from U.S. 3/	897	913	734
Trade Balance 3/	-378	-606	-276
Balance with U.S. 3/	-855	-872	-695
External Public Debt	1,336	1,437	1,475
Fiscal Deficit/GDP (pct)	1.7	-0.8	-1.2
Current Account Deficit/GDP (pct)	-3.3	-5.0	-2.7
Debt Service Payments/GDP (pct)	18	17	19
Gold and Foreign Exchange Reserves	1,062	846	870
Aid from U.S.	5.0	5.0	N/A
Aid from All Other Sources	N/A	N/A	N/A

1/ 1998 figures are central bank preliminary data except for U.S. imports and exports, which are embassy estimates.
2/ Percentage changes calculated in local currency.
3/ Merchandise trade.

1. General Policy Framework

Paraguayans elected a new president, congress, and governors on May 10, 1998. The new government has made economic reform, led by reform of the banking sector, its principal goal, and has submitted a plan to congress for a package of international and national bond issuances to pay depositors of failed or merged banks, and bolster foreign reserves. Some important steps have been made in the protection of intellectual property rights, and the Finance Ministry and its customs branch have reviewed tax and duty collection procedures. The financial sector continued to be in upheaval, with the closure of several banks and exchange houses, and subsistence farming, particularly cotton, continued to struggle due to poor weather conditions and mismanagement of the government's cotton reactivation program. Inflation exceeded the annual target rate by the fourth quarter, forcing the central bank to reevaluate its policies. The new government found the public deficit to be almost twice as large as originally believed. The Cubas administration has taken some effective measures to increase revenue and cut spending with the goal of balancing the budget by the end of 1999.

Key hurdles to continued reform are congressional and executive inability to rise above partisan politics, endemic corruption, negative fallout from prior year privatization efforts, and a drop in the previously lucrative re-export trade to Brazil. Paraguay's membership in the Southern Cone Common Market (MERCOSUR) continues to pose more immediate challenges than benefits, but continues to be a primary attraction for foreign investors. Paraguay is the region's lowest cost provider of electricity, and could serve as a strong base in certain industries for entering the 200 million-consumer MERCOSUR market.

Paraguayan imports of U.S. goods have dropped over the last several years after impressive growth in the early part of the decade. The imports reflect not only local consumer and business demand, but that of neighboring countries as well. A significant portion of Paraguayan importers take advantage of "leakage" in local customs and tariff enforcement to import goods to Paraguay for transshipment to Brazil and Argentina. While some legitimate goods are transshipped, an increasing percentage of transshipped goods are unlicensed copies of CDs, video games, software, cellular telephone batteries, designer items, etc. With tariff rates in Argentina and Brazil falling and rising in Paraguay as part of a planned MERCOSUR-wide common tariff regime, Paraguay's relative tariffs no longer provide sufficient margins on the transshipment of many legitimate goods.

2. Exchange Rate Policy

All foreign exchange transactions are settled at the daily free market rate. The central bank practices a dirty float, with periodic interventions aimed at stabilizing the guarani. The decline of illicit/informal cross-border trade with Brazil, coupled with rising inflation, has caused a 35 percent devaluation of the guarani in the past year. On November 9, the market rate stood at 2,850 guaranies to the dollar. It is legal to hold savings accounts in foreign currency, and in October 1994 a decree was promulgated that legalized contractual obligations in foreign currencies. With continuing economic uncertainty, the failure of many local banks, and continued inflation, the dollar has become the preferred unit for large purchases, savings, and virtually all international transactions. Dollar-based savings accounts total over one billion dollars.

3. Structural Policies

Consumer prices are generally determined by supply and demand, except for public sector utility rates (water, electricity, telephone), petroleum products, pharmaceutical products and public transportation fares. The Ministry of Finance oversees all tax matters. Under current law, corporate incomes are subject to a 30 percent tax rate. There is no personal income tax. As an incentive to investment, the tax rate on reinvested profits is 10 percent. The existing Investment Promotion Law (law 60/90) includes complete exemption from start-up taxes and customs duties on imports of capital goods. There is a 95 percent corporate income tax exemption for five years on the income generated directly from reinvested profits. The government implemented a Value-Added Tax (IVA) in 1992. Some analysts have estimated that IVA compliance hovers around 30 percent. Charges of corruption among tax officials are endemic. The bulk of tax revenues are collected by customs on imported merchandise.

4. Debt Management Policies

In 1992, the government reduced external debt with both official and commercial creditors through a drawdown of foreign reserves. Since that time, however, increasingly large public deficits have nudged public debt back upward. Foreign reserves have not recovered, however, and Paraguay currently has about $740 million in hard currency. The government's debt is approximately $1.5 billion. The government has sent legislation to the congress authorizing an international bond issue of $400 million and a local bond issue of $200 million, to be used to bail out the ailing banking sector and shore up international reserves. Further, Japan and Taiwan have recently provided over $200 million in long-term foreign assistance loans for agriculture and infrastructure development. Approximately two-thirds (roughly $900 million) of Paraguay's foreign debt is held by multilateral lending institutions. During a recent visit, a representative from the World Bank announced that no new World Bank loans would be available to Paraguay until it allocated and properly accounted for existing loans. Paraguay continues to meet its obligations to foreign creditors in a timely fashion.

5. Aid

Direct U.S. aid to Paraguay in fiscal year 1998 included roughly $675,000 in military assistance administered at post, such as international military education and training, information exchange visits and seminars; $105 thousand in counter-narcotics assistance; and $6.125 million in USAID disbursements for democracy, reproductive health and biodiversity protection. Indirect U.S. contributions via the Inter-American Development Bank, World Bank and United Nations programs totaled tens of millions of dollars more.

6. Significant Barriers to U.S. Exports

Paraguay is a member of the World Trade Organization (WTO) and has an open market that does not require import licenses, except for guns and ammunition (the United States prohibits the export of U.S. guns and ammunition to Paraguay). U.S. companies have not fared well in non-transparent government procurement tenders. Paraguayan regulations require country of origin designation on domestic and imported products. Expiration dates are required for medical products and some consumer goods. As of January 1998, imported beer is required to display detailed manufacture and content information, labeled in Spanish at the point of bottling. A similar regulation was put in place for shoes. MERCOSUR-wide labeling requirements are underway.

Law 194/93 established the legal regime between foreign companies and their Paraguayan representatives. This law requires that to break a contractual relation with its Paraguayan distributor, the foreign company must prove just cause in a Paraguayan court. If the relationship is ended without just cause, the foreign company must pay an indemnity. The rights under this law cannot be waived as part of the contractual relationship between both parties. Foreign companies have paid large sums when ending distributor relationships in Paraguay to avoid lengthy court cases or have maintained relationships with underperforming representatives to avoid such payments.

7. Export Subsidies Policies

There are no discriminatory or preferential export policies. Paraguay does not subsidize its exports. In fact, export taxes and duties represent a significant source of central government revenues.

However, Paraguay exports 90 percent of its cotton crop and government subsidized credit to small-scale producers signifies an indirect export subsidy. Government subsidized financing for the 1997-98 crop was provided to the producers of 80 percent of the cotton harvest. Due to high default rates, subsidized credit for the 1998-99 crop has been reduced to cover only 30 percent of production. The government will provide small-scale farmers with subsidized input, such as seed and pest control products.

8. Protection of U.S. Intellectual Property

Paraguay belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). It is also a signatory to the Paris Convention, Berne Convention, Rome Convention, and the Phonograms Convention. In 1998, the U.S. Trade Representative designated Paraguay as a "Special 301" Priority Foreign Country. On February 17, 1998, the U.S. Government initiated a "Special 301" investigation of Paraguay as a result of its historically inadequate enforcement of intellectual property rights, its failure to enact adequate and effective IP legislation, as well as its status as a distribution and assembly center for pirate and counterfeit merchandise and the large re-export trade to other MERCOSUR countries.

On November 17, USTR concluded a Memorandum of Understanding and an Enforcement Action Plan that contain specific near-term and longer-term obligations. The Agreement contains commitments by Paraguay to take immediate action against known centers of piracy and counterfeiting; initiate a Special Enforcement Period (to last until March 15, 1999), during which intensive action will be taken to prevent and punish the infringement of intellectual property rights; pursue amendments to its laws that will facilitate effective prosecution of copyright piracy; coordinate the anti-piracy efforts of its customs, police, prosecutorial, and tax authorities; implement institutional reforms to strengthen enforcement at its borders; and ensure that its government ministries use only authorized software.

As a result of this agreement, the U.S. Government has revoked Paraguay's designation as a Priority Foreign Country and terminated the Special 301 investigation. The U.S. Government also designated Paraguay for "Section 306 Monitoring" to demonstrate the need for continued improvement, allowing the U.S. to move directly to trade sanctions if there is slippage in Paraguay's enforcement of this agreement.

Patents: Congress has not taken up comprehensive patent legislation. Lobbying against the legislation has complicated action in congress.

Trademarks: On August 6, 1998, a new Trademark Law was promulgated that includes a broader definition of trademarks. The law prohibits the registration of a trademark by parties with no legitimate interests or who knew or should have known that another party already owned the mark. Provisions provide specific protection for well-known trademarks. The law also includes stronger enforcement measures and penalties for infractions. In practical terms, trademark violation is still rampant in Paraguay, and resolution in the courts is slow and non-transparent. The new law provides an important first step, but must be followed by increased enforcement and modernization of the judicial system to become fully effective.

Copyrights: On October 15, 1998, President Cubas signed a new Copyright Law, which follows international conventions to protect all classes of creative works. Software programs receive the same treatment as literary works under the law. The law contains norms that regulate contracts related to copyrights. A reform in the procedural guide to the penal code, which goes into effect June 1999, will make copyright violations "private actions," requiring legal action by the offended party to seek redress. The Ministry of Commerce is leading an effort to make copyright violations a "public action," opening the door to litigation by public prosecutors. Practical application of copyright protection suffers the same systemic challenges as trademark protection.

9. Worker Rights

In October 1993 the Paraguayan Congress approved a new Labor Code that met International Labor Organization standards.

a. The Right of Association: The Constitution allows both private and public sector workers, except the armed forces and police, to form and join unions without government interference. It also protects the right to strike and bans binding arbitration. Strikers and leaders are protected by the Constitution against retribution. Unions are free to maintain contact with regional and international labor organizations.

b. The Right to Organize and Bargain Collectively: The law protects collective bargaining. When wages are not set in free negotiations between unions and employers, they are made a condition of individual employment offered to employees. Collective contracts are still the exception rather than the norm in labor/management relations.

c. Prohibition of Forced or Compulsory Labor: The law prohibits forced labor. Domestics, children, and foreign workers are not forced to remain in situations amounting to coerced or bonded labor.

d. Minimum Age for Employment of Children: Minors from 15 to 18 years of age can be employed only with parental authorization and cannot be employed under dangerous or unhealthy conditions. Children between 12 and 15 years of age may be employed only in family enterprises, apprenticeships, or in agriculture. The Labor Code prohibits work by children under 12 years of age, and all children are required to attend elementary school. In practice, however, many thousands of children, many under the age of 12, work in urban streets in informal employment.

e. Acceptable Conditions of Work: The Labor Code allows for a standard legal work week of 48 hours, 42 hours for night work, with one day of rest. The law also provides for a minimum wage, an annual bonus of one month's salary, and a minimum of six vacation days a year. It also requires overtime payment for hours in excess of the standard. Conditions of safety, hygiene, and comfort are stipulated.

f. Rights in Sectors with U.S. Investment: Conditions are generally the same as in other sectors of the economy.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 1997

(Millions of U.S. Dollars)

Category		Amount
Petroleum		11
Total Manufacturing		27
Food & Kindred Products	0	
Chemicals & Allied Products	6	
Primary & Fabricated Metals	0	
Industrial Machinery and Equipment	0	
Electric & Electronic Equipment	0	
Transportation Equipment	0	
Other Manufacturing	21	
Wholesale Trade		(1)
Banking		(1)
Finance/Insurance/Real Estate		0
Services		0
Other Industries		2
TOTAL ALL INDUSTRIES		151

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.